International Sovereign Energy Corp.

ANNUAL REPORT 2003

CORPORATE PROFILE

International Sovereign Energy Corp. is a Canadian based publicly traded exploration and development company with offices in Vancouver, British Columbia; Calgary, Alberta and Islamabad, Pakistan and is active in the exploration and development of hydrocarbon reserves in Western Canada and internationally.

The Company, incorporated in 1992, owns and operates a strong asset base of producing oil and gas properties in Western Canada that it continues to maintain through the drilling of internally generated low to medium risk exploration and development opportunities. This conservative, low risk approach to growth in Western Canada provides the Company with a substantial asset base from which to identify and pursue late stage exploration or early stage development opportunities internationally.

The Company is committed to maximizing shareholder value through the rapid growth expected from its international initiatives as well as through increasing its Western Canadian reserve base.

The shares of International Sovereign Energy Corp. are publicly traded on the TSX Exchange under the symbol "ISR". At year-end 2003, the Company had 7,101,036 shares issued and outstanding.

Annual Meeting

The Annual General & Special Meeting of Shareholders of the Corporation will be held on Wednesday, June 9, 2004 at 2:30 p.m. in the Grouse Room, 34th floor, at the Hyatt Regency Hotel located at 655 Burrard St., Vancouver, British Columbia. Shareholders and members of the public who are interested in receiving additional information on the Company are encouraged to attend.

Contents

Abbreviations

ARTC	Alberta Royalty Tax Credit
bbl	barrel
bbls/d	barrels per day
bcf	billions of cubic feet
boe	barrel of oil equivalent (1 bbl = 6 mcf)
bopd	barrels of oil per day
BTU	British Thermal Unit
m	thousands
mcf	thousands of cubic feet
mm	millions
mmcf	millions of cubic feet
Ngls	natural gas liquids

HIGHLIGHTS YEAR IN REVIEW

	2003	2002
Operating		
Production		
Oil & Ngls (bbls)	174,576	162,533
Per day	478	445
Natural Gas (mcf)	498,084	322,432
Per day	1,365	883
Exit Production		
Oil & Ngls (bopd)	496	468
Natural Gas (mcf per day)	1,822	891
Proven and Probable Reserves		
Oil & Ngls (mbbls)	1,603	1,419
Natural Gas (mmcf)	5,475	3,256
Average Price Received		
Oil ($ per bbl)	28.87	29.16
Natural Gas ($ per mcf)	5.78	3.51

	2003	2002
Financial		
Gross Revenue	$ 7,917,716	$ 5,714,310
Cash Flow	3,769,673	2,892,019
Per Share	0.56	0.45
Net Income	1,383,195	728,926
Per Share	0.21	0.11
Capital Expenditures	4,533,101	2,571,033
Acquisitions	0.00	0.00
Divestitures	141,830	0.00
Long Term Debt	0.00	0.00
Net Asset Value (15% DCF)	18,847,990	14,602,498
Per Share	$ 2.65	$ 2.27
Class A Common Shares Issued at Year End	7,101,036	6,445,323

For the purpose of cash flow per share calculations, cash flow is defined as "Cash flow from operations" before the changes in non-cash working capital. This definition is not a recognized measure under Canadian generally accepted accounting principles and accordingly may not be comparable to measures used by other companies.

MESSAGE TO SHAREHOLDERS

Lutfur Rahman Khan
President and
Chief Executive Officer

I am pleased to report that 2003 was a year of significant growth and achievement for the Company. Cash flow was up 30 percent to $3.77 million ($0.56 per share) while earnings increased by 90 percent over the year 2002 to $1.38 million ($0.21 per share).

I am also pleased to advise that on March 1, 2004 the Company's shares commenced trading on the Toronto Stock Exchange (TSX). Graduating from the Venture Exchange to the senior board of Canada's premier exchange will enable the Company to increase its profile within the investment community as well as broaden its access to the capital markets in order to further develop the Company's domestic portfolio and its targeted international projects.

Our commitment to increasing our Western Canadian production base through internally generated prospects and growth "through the drill bit" was rewarded with a 74 percent success rate on a net well basis, resulting in a net increase in reserves. The implementation of more strict reserve reporting practices has caused some companies to adjust their reserves downward. As many of the Company's properties are part of, or analogous to, large pools with significant production history the Company's reserves, even with the move to more conservative evaluation parameters, has not resulted in any excessive downward adjustments as at the Company's fiscal year end. Indeed, the Company was successful in replacing its production for 2003 by adding 68 percent to its gas reserves and 13 percent to its oil reserves for a combined increase of 28 percent to its proved plus probable reserve base. The quality of the Company's reserves is reflected in a 9-year reserve life index for oil and an 8-year reserve life index for natural gas.

As the strength of the Company's Western Canadian assets is critical to the Company's ability to maintain its international initiatives, the Company is firmly committed to maintaining the exploration momentum on domestic properties going forward. Subsequent to year-end, the Company drilled two successful 25 percent working interest gas wells in the Sturgeon Lake area of Alberta with a third well planned for mid-year. In addition, drilling operations are planned at Medicine River and Little Bow in Alberta as well as at Red Deer where seismic and land acquisition is proceeding.

Mr. Robert Fabes, Vice President of the TSX presents the certificate of listing on the Toronto Stock Exchange to Mr. Lutfur Rahman Khan.

The Company's international activities remain the second focal point and although the results to date are not as visible as our Canadian efforts, they are equally exciting. During the past years, we first identified regions of interest, then focused on these regions and identified world-class oil projects within them that satisfied our criteria for late stage exploration or early stage development potential. Concurrent with the technical work was the development of relationships within each of these areas that would assist the Company in furthering and implementing its initiatives. Projects that fit the Company's criteria with upside potential in Ecuador, South America; Azerbaijan, Kazakhstan in the Caspian Region; and Pakistan in Central Asia, among others, have been identified and discussions to secure such projects are ongoing.

The objective for the forthcoming year is to continue the Company's progressive growth. The mandate is to significantly increase the production base in Western Canada during the year 2004 and in combination with the various identified international projects the Company is poised to move to the next level.

In closing, and on behalf of the Board of Directors, I would like to thank the Company's staff and shareholders for their continued support and confidence as we begin the next chapter in our overall development and strategic growth.

Lutfur Rahman Khan
President and Chief Executive Officer

March 25, 2004

OPERATIONS AND PRODUCTION

Operations

The Company participated in the drilling of nine gross wells and one re-entry during the year with seven of the operations targeting gas. The drilling program resulted in three successful oil wells and three successful gas wells for a 74 percent success rate on a net well basis.

Gas production averaged 1,365 mcf/d for the year, up 55 percent over last year's rates while oil reflected a modest seven percent increase to 478 bopd.

Three new focus areas have been added to our existing areas in order to meet our commitment to achieving rapid growth in our domestic production rate and reserve base.

Sturgeon Lake

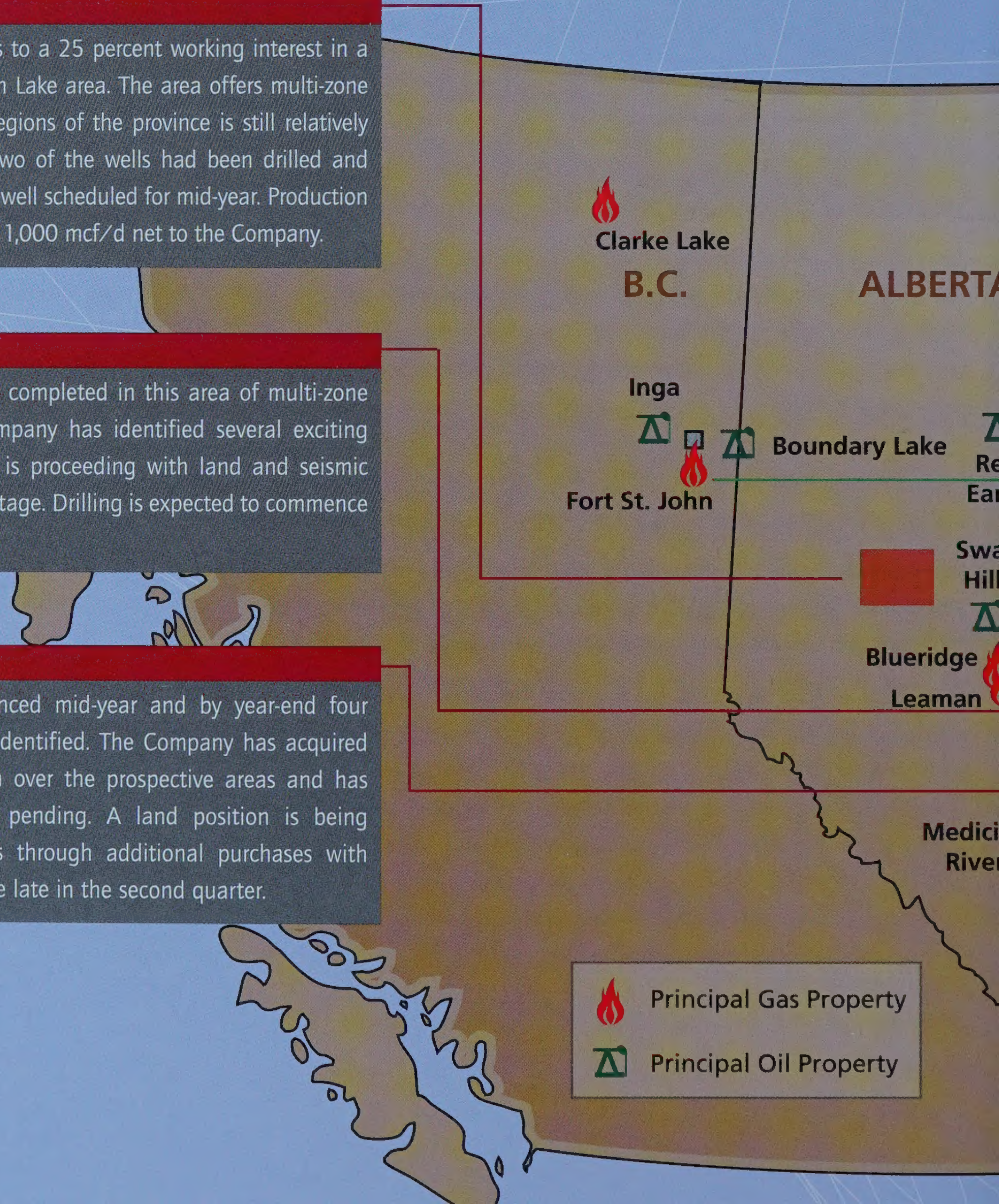
The Company committed to participate as to a 25 percent working interest in a three well drilling program in the Sturgeon Lake area. The area offers multi-zone gas potential and compared with other regions of the province is still relatively under-explored. Subsequent to year-end two of the wells had been drilled and cased as potential gas wells with the third well scheduled for mid-year. Production from the two new wells is expected to add 1,000 mcf/d net to the Company.

Cherhill

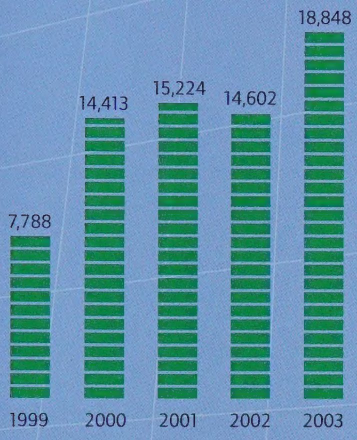
A regional mapping project was recently completed in this area of multi-zone potential for both gas and oil. The Company has identified several exciting one bcf to three bcf gas prospects and is proceeding with land and seismic acquisition to mature them to a drillable stage. Drilling is expected to commence late in the second half of 2004.

Lacombe – Chigwell

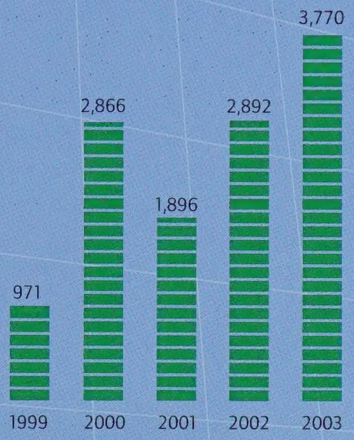
Regional mapping in this area commenced mid-year and by year-end four medium depth gas prospects had been identified. The Company has acquired both trade and proprietary seismic data over the prospective areas and has concluded one farm-in with a second pending. A land position is being established on the remaining prospects through additional purchases with drilling in the area expected to commence late in the second quarter.



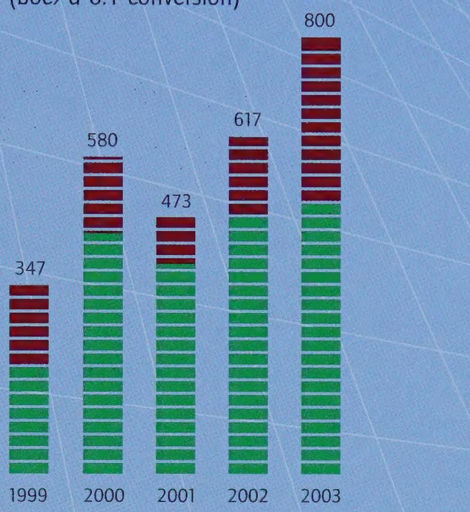
Net Asset Value
(15% DCF, $ Thousands)
(Pre Tax)

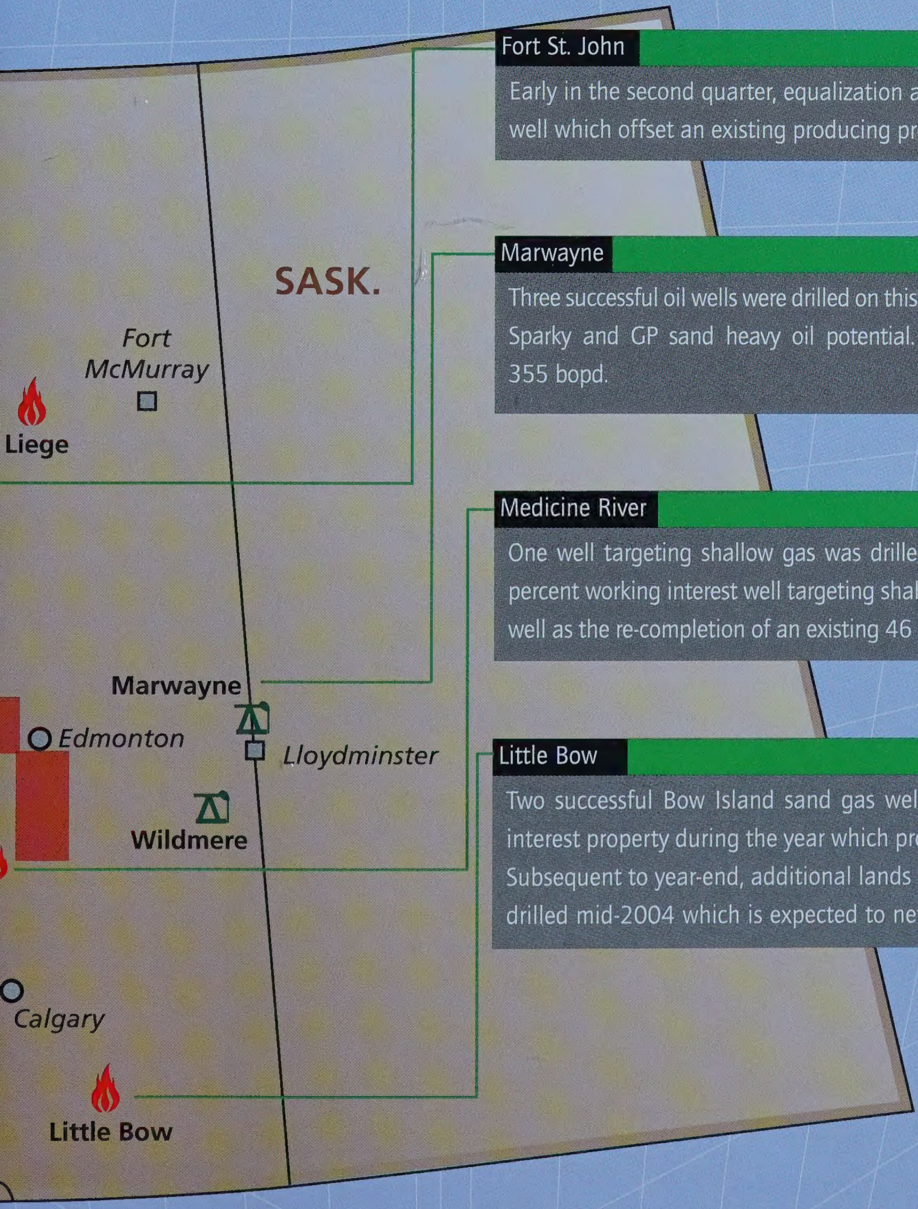


Cash Flow
($ Thousands)



Production
Year End Exit Rates
(boe/d 6:1 conversion)





Fort St. John

Early in the second quarter, equalization as to a 7.5 percent working interest in a new Belloy gas well which offset an existing producing property netted the Company approximately 500 mcf/d.

Marwayne

Three successful oil wells were drilled on this 100 percent working interest property in 2003 targeting Sparky and GP sand heavy oil potential. The property exited the year producing at a rate of 355 bopd.

Medicine River

One well targeting shallow gas was drilled and abandoned in this area during the year. A 50 percent working interest well targeting shallow Cretaceous gas is planned for the upcoming year as well as the re-completion of an existing 46 percent working interest marginal producer, also for gas.

Little Bow

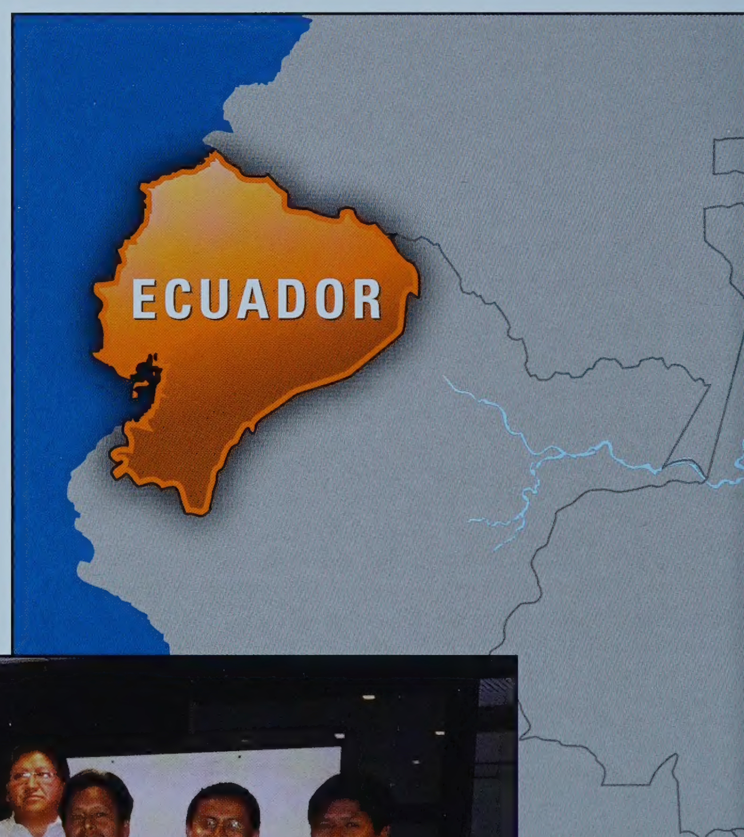
Two successful Bow Island sand gas wells were drilled on this 66.67 percent (BPO) working interest property during the year which provided approximately 700 mcf/d net to the Company. Subsequent to year-end, additional lands were acquired on the prospect and a third well will be drilled mid-2004 which is expected to net the Company an additional 500 mcf/d.

INTERNATIONAL HIGHLIGHTS

Ecuador

For the past three years, International Sovereign has been actively evaluating projects and developing the necessary relationships to firmly establish itself in the country. Through regional technical evaluation of Ecuador's Oriente basin, we have isolated certain projects that fall within our rigorous selection criteria and have being working diligently to secure these projects for exploitation by the Company.

As is the case in many countries with emerging economies, Ecuador suffers with the instability that results from often changing governments and a politically active population. Over 40 percent of Ecuador's population is made up of indigenous peoples and a large percentage of this population believes that they derive virtually no benefit from the production of hydrocarbons from beneath the lands on which they have lived for centuries.



International Sovereign is the first hydrocarbon exploration company in Ecuador ever to form a partnership with the indigenous people of the area to allow them a direct participation in the country's hydrocarbon industry. Through our formal alliance with the "Federation of the Union of Communities of the Ecuadorian Amazon" ("FCUNAE") and Amazonia Energy, a company that is the property of the FCUNAE established for their direct participation in the hydrocarbon industry, Sovereign has established a unique business relationship that should ensure its success in working in the region.

The Alliance with Ecuador's indigenous people; a first for South America.

Front Row: Ing. Manuel Buenano, Etienne Walter, Consul General of Ecuador in W. Canada.
Back Row: George Bowley; Rafael Alvarado, FCUNAE leader; Carlos Arboleda, former Minister of Energy and Mines; Edwin Piedra Jacome, Manager, Amazonia Energy; Luis Gerardo Grefa, Freddy Grefa, Nicolas Yuimbo Chimbo, FCUNAE leaders.

Caspian Region

Under Soviet rule, the Caspian region was an important hydrocarbon producing center for the former Soviet Union. The Soviet system however, did not allow for the effective exploration of its resources, or for the proper development and maintenance of its reservoirs using good production practice standards that western companies commonly apply.

With the break-up of the former Soviet Union and the gaining of independence by the former Soviet republics came a period of inactivity in the hydrocarbon sector for the region as new independent governments had to formulate and implement plans and policies for all sectors of their economy. Fields large and small all over the region deteriorated as a result of lack of capital and technology.

The early entrepreneurs that emerged from the new independence were not equipped to deal with the complexities of rehabilitating the tired fields and deteriorated infrastructure the region required and their efforts were less than successful. By the late nineties, the republics were looking to the west for technology and capital to revitalize their industry and arrest the declining production.

International Sovereign recognized the importance of the region and the opportunity it represented with it's underdeveloped reserve and marketing potential. In 2001, the Company commenced its technical appraisals, starting first in Azerbaijan and then expanding to include Kazakhstan and Turkmenistan. As a result of this work, our focus became an oil rehabilitation project in Azerbaijan and a gas condensate development project in Kazakhstan, with negotiation of both projects still ongoing.

Central Asia

Pakistan continues to be a country that we pursue for late stage exploration or exploitation type opportunities. A well developed infrastructure and a sizeable domestic oil and gas market combined with a transparent and open regulatory environment and improved returns on investment through new fiscal incentives make this an attractive place to pursue opportunities.

ISR

RESERVES

In this report, all reserves and value of those reserves for years prior to the reporting period is based upon proved plus 50 percent of probable reserves (ie: "established reserves" as per the January 1, 2003 Canadian Oil and Gas Evaluation Handbook). The reserves and their value used for the reporting period are per the January 1, 2004 definition of proved plus probable reserves that are similar but not identical to the previous definition.

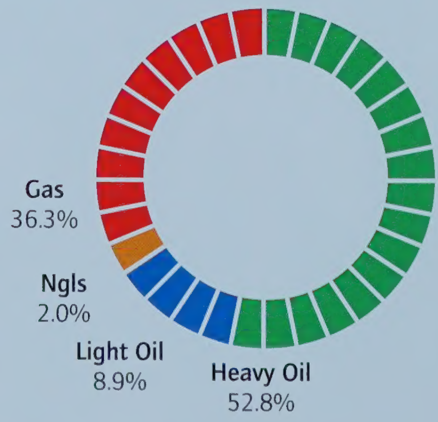
On a boe basis, the Company reported a 28 percent increase in its proved plus probable reserve base as at December 31, 2003 over the year prior. 63 percent of corporate reserves are classified as proven. Gas reserves were up an impressive 68 percent, moving the Company closer to its goal of a balanced product mix while oil reserves were up 13 percent.

Based on the Company's exit production rates and proved plus probable reserves, our reserve life index is 9.2 years for oil and natural gas liquids and 11 years for natural gas.

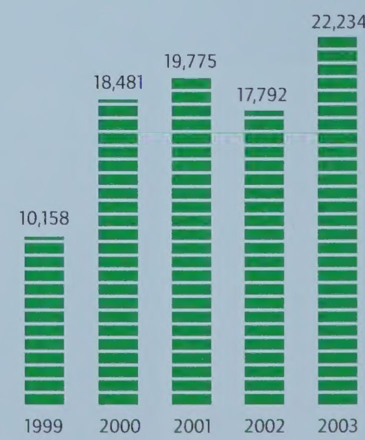
Domestic capital spending for the period totaled $3,763,573 that resulted in the addition of 553.5 mboe of new reserves for a finding and development cost of $6.80 per boe.

Reserves
(mboe 6:1 Conversion)

Reserve Allocation
(mboe 6:1 Conversion)



Net Present Value of Reserves
(10% DCF, $ Thousands)



Numbers may not add exactly due to rounding.

Pricing

	Crude Oil Edmonton Light Sweet ($Cdn. Per bbl)	
	Effective 1/1/04	Effective 1/1/03
2004	38.17	36.52
2005	35.50	34.98
2006	34.17	34.98
2007	32.83	35.51
2008	33.33	36.04
2009	33.83	36.58
2010	34.33	37.13
2011	34.85	37.69
2012	35.37	38.25
2013	35.90	38.83
2014	36.44	39.41

	Gas Reference Price ($Cdn. Per mmbtu)	
	Effective 1/1/04	Effective 1/1/03
2004	5.25	4.75
2005	5.00	4.50
2006	4.75	4.50
2007	4.75	4.50
2008	4.75	4.57
2009	4.75	4.64
2010	4.75	4.71
2011	4.82	4.78
2012	4.89	4.85
2013	4.97	4.92
2014	5.04	4.99

The table below presents the Company's proved plus probable reserves before royalties as evaluated by the independent firm of Chapman Petroleum Engineering Ltd. as at January 1, 2004.

Reserves

	Proved	Probable	Total
Gas (mmcf)	2,541	2,934	5,475
Light & Med. Oil (mbbls)	153	70	222
Heavy Oil (mbbls)	998	331	1,329
Ngls (mbbls)	17	36	52
Total (mboe)	1,592	926	2,516

The table below presents the discounted present value of the Company's reserves as at January 1, 2004.

Present Value of Reserves

$ Thousands

Present Value, before tax, discounted at	10%	15%
Proven	15,567	13,825
Probable	6,667	5,292
Total	22,234	19,117

Subsequent to year-end, in March of 2004, three of our GP heavy oil wells at Marwayne began to produce significant water. By the beginning of the second quarter it became apparent that the GP production in the Company's portion of the field had watered out. All of the Company's wells are planned for re-completion up-hole for oil production in the Sparky. The Company expects that oil production for the property will resume during the second quarter at a rate of 125 bopd – 150 bopd and that gas production from wells already drilled in 2004 will more than replace the loss of production from the GP.

MANAGEMENT'S DISCUSSION AND ANALYSIS AS AT MARCH 25, 2004

The following is management's discussion and analysis ("MD&A") of International Sovereign's operating and financial results for the years ended December 31, 2003 and 2002 as well as information concerning the Company's future outlook based on currently available information. This MD&A should be read in conjunction with the Company's December 31, 2003 and 2002 consolidated financial statements and related notes.

Forward-Looking Information

This MD&A contains forward-looking or outlook information which reflects management's expectations regarding the Company's growth, results of operations, performance and business prospectus and opportunities. The use of words such as "anticipate", "continue", "estimate", "expect", "may", "will", "project", "should", "believe", "outlook", "forecast" and similar expressions are intended to identify forward-looking statements. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results of events to differ materially from those anticipated in these forward-looking statements. Although management believes the expectations reflected in these forward-looking statements are reasonable, there can be no assurance that actual results will be consistent with these forward-looking statements. Readers should not put undue reliance on forward-looking information. These statements are made as of the date hereof and management assumes no obligation to update or revise these statements to reflect new events or circumstances.

Production and Revenue

Revenues for the period were $7,917,716, an increase of 39 percent over the 2002 level of $5,714,310. This was due to both increased production throughout the year, particularly of natural gas, and also an increase in natural gas prices over the prior year. Natural gas production increased 55 percent in 2003 from 883 mcf per day to 1,365 mcf per day. This increase is primarily from a 7.5 percent WI in a gas well in the Fort St. John area that came on production in June 2003, a 66.67 percent BPO (before payout) working interest gas well located in Little Bow which commenced production in July and a second Little Bow location which came on production in September, also with a 66.67 percent BPO working interest. Average oil production was up seven percent over the corresponding period in 2002, from 445 bbls per day to 478 bbls per day in 2003, which is mainly attributable to new Marwayne heavy oil coming on production in June. The average gas price in 2003 was $5.78 per mcf, an increase of 65 percent over $3.51 per mcf received in 2002. Average oil prices remained relatively constant, falling slightly from $29.16 per bbl in 2002 to $28.87 per bbl in 2003. As a large proportion of the Company's oil production is heavy oil, the trend for its average oil prices follows heavy oil prices, not those of lighter crude.

Royalties

Royalties, net of Alberta Royalty Tax Credit increased significantly from $592,350 in 2002 to $1,088,134 in 2003, which reflects an 84 percent increase. However, royalties as a percentage of revenues only increased from 10 percent in 2002 to 14 percent in 2003. This was due in part to both increased gas production and gas prices. Gas royalties are price sensitive, which resulted in a higher overall gas royalty rate for the year. The other major factor affecting the increase in royalties was Freehold and Overriding Royalty obligations attached to the two new Little Bow wells.

Operating Costs

Operating costs totalled $1,654,568 in 2003, which equates to $6.42 per boe, up from $5.52 per boe in 2002. This increase is a result of increased industry activity leading to higher costs, as well as higher fuel costs. Also, in the third quarter of 2003 the Company received retroactive processing fee billings on a gas facility, from July 2000 to present. As well, replacement pumps and motors were required on a number of heavy oil wells in the later part of 2003.

General and Administrative

Total general and administrative expenses increased 21 percent from $989,681 in 2002 to $1,196,771 in 2003. This was the result of increased activity within the Company, requiring increased technical consulting services both for domestic and foreign prospects. Also, as a result of increased staffing the Company acquired additional office space in December 2003.

Interest

The 2003 interest expense was down from $27,567 in 2002 to $6,675 in 2003. In 2003 due to increased cash flows it has not been necessary to use the available line of credit, except to a very minor extent. At the end of 2003, the available line of credit of $4,400,000 was not drawn upon.

Depletion, Depreciation and Site Restoration

Total depletion, depreciation and site restoration provision was up substantially from $1,627,619 for the year ended 2002 to $2,251,976 for the year ended 2003, representing an increase of 38 percent. This increase was due, in part, to capitalized costs of $461,563 related to the impairment of certain international cost centers having been charged to depletion. Had depletion been calculated prior to this charge the depletion rate for 2003 was $6.24 per boe up from $4.14 per boe at year end 2002. This was due in part, to a reduction in total proved developed reserves from year end 2002 to 2003. At the end of 2002 proved developed reserves were 1,734,834 boe compared to 1,521,667 boe at the end of 2003. The other contributing factor to the increase in depletion per boe was some of the new production in 2003 having a fairly rapid initial decline rate.

Capital Expenditures

Total capital expenditures for the year ending 2003 were $4,533,101, up 72 percent from the 2002 year end number of $2,642,755. This increase was the result of increases in spending on operations consisting of drilling and completions, re-completions, workovers and abandonment and international pursuits. The breakdown of these capital expenditures for 2003 was domestic spending $3,763,573, international spending $694,528. Comparative numbers for 2002 were domestic capital expenditures $1,822,486, international $820,269. These increased capital expenditures were reflected in increased corporate production rates, particularly of natural gas.

Liquidity and Capital Resources

At December 31, 2003 International Sovereign's market value of common shares was $11,858,730 based on the closing price of $1.67 per share times 7,101,036 shares outstanding. Cash flow from operations was $3,769,673, up 30 percent from $2,892,019 at the end of 2002. This equated to an increase from $0.45 per basic share in 2002 to $0.56 per basic share in 2003. Cash flow from operations is provided to assist management and investors in determining the ability of the Company to generate cash from operations. It is calculated from the consolidated statements of operations as net earnings adjusted for items that do not affect cash. This measure does not have any standardized meaning prescribed by GAAP and may not be comparable to similar measures presented by other companies. At the end of December 2003, International Sovereign had an undrawn operating line of credit of $4,400,000 and no long term debt.

Stock Based Compensation and Other Stock Based Compensation

Effective January 1, 2003 the Company elected to prospectively adopt the fair value method of accounting for options granted subsequent to January 1, 2003 under its stock based compensation plan as recommended by the CICA. Compensation expense has been recognized in the consolidated statement of operations with a corresponding increase recorded to contributed surplus in the consolidated balance sheet as at and for the year ended December 31, 2003 using the fair value method. This change in accounting policy did not have an effect on the financial statements.

Previously, the Company accounted for this stock based compensation using intrinsic values as defined by the CICA and accordingly, did not recognize compensation expense in the consolidated financial statements for share options granted to employees and directors when issued at market value.

The Company's stock based compensation plan and the impact on net earnings and net earnings per share had compensation expense been recognized for options granted prior to 2003 using the fair value method of accounting for stock options issued to employees and directors on or after January 1, 2002 would have been a reduction in net income of $14,688 and a reduction of $0.01 per share in basic earnings per share, with no effect on diluted earnings per share.

Contractual Obligations

As part of normal operations, International Sovereign is a party to various financial guarantees, letters of credit and other contractual commitments. Oil sales from Company production are contracted on a month-to-month evergreen basis and gas sales from Company production are contracted on an annual basis commencing each November. International Sovereign also has a letter of credit outstanding totaling $7,500 to maintain its status as a licensed well operator in the province of British Columbia. The Company also has a legal obligation to reclaim the lands on which they have production wells and/or facilities. These obligations come due at varying times, dependent upon when economic production ceases and the property is then available for abandonment and reclamation operations.

Transactions with Related Parties

During the year, the Company recovered $ Nil (2002 – $33,357) in general and administrative expenses from a corporation which has a director in common with the Company. At December 31, 2003, accounts payable of $20,852 (2002 – $22,683) include balances owing to a company which have a director in common with the Company. During the year, the Company paid $85,525 (2002 – $43,833) for legal services in the normal course of business to a law firm of which the partner is an officer of the Company. Also, effective March 1, 2003, the Company sold a minor interest property to a corporation which has an officer in common with the Company, for a consideration of $46,000. Transactions are determined and recorded at their fair value.

Critical Accounting Estimates

Depletion

The Company accounts for oil and gas properties using the full-cost method of accounting. Under this method, depletion and restoration expenses are recorded using the unit-of-production method. Cost of all costs related to exploration and development of oil and gas reserves are capitalized on a country by country basis. Such costs include lease acquisition costs, geological and geophysical expenses, carrying charges on non-producing properties, costs of drilling productive and non-productive wells and overhead charges related directly to acquisition, exploration and development activities.

Depletion is an estimate of the reduction in recoverable costs of oil and gas properties during the year, matched against the related income. It is based on reserve estimates, which are evaluated by an independent third party. The determination of the quality and quantity of recoverable reserves is also an area of risk. Oil and gas reserves are integral to assessing expected future financial performance, preparing financial statements and making investment decisions. There are numerous uncertainties inherent in estimating quantities of proved oil and natural gas reserves, including many factors beyond the Company's control. The reserves used in calculating depletion and impairment of capital assets represent estimates only.

International Sovereign mitigates this risk by having the reserves evaluation performed by a reputable third party consultant. The Company's Reserves Committee of the Board of Directors reviews the work and independence of this firm.

Costs of acquiring and evaluating unproven properties in Canada and costs of exploration and land in international cost centers are initially excluded from costs subject to depletion, until it is determined whether or not proved reserves are attributable to the properties or, in the case of major development projects, commercial production has commenced, or impairment has occurred. Impairment occurs whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When proven reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to the costs subject to depletion for that country's cost centre. Proceeds from disposal of properties will normally be applied as a reduction of the cost of the remaining assets unless the disposal represents a significant disposition of reserves, in which case a gain or loss will be recorded.

Beginning in January 2004 a new full cost accounting guideline for the oil and gas industry (AcG 16 – "Oil and Gas Accounting Full Cost") will be implemented. This guideline provides new guidance in conducting the ceiling test on oil and gas assets. The new ceiling test requires management to determine a fair value of the oil and gas assets. This should be determined by estimating the present value of future cash flows based on management's best estimate of the future operating environment using proved plus probable reserves. The old ceiling test (under AcG 5 – full cost accounting in the oil and gas industry) determined the recoverable amount of capital assets to be the undiscounted future value of cash flows based on year end estimates using total proved reserves.

Given the significant assumptions required and the possibility that actual conditions will differ, International Sovereign considers the assessment of impairment to be a critical accounting estimate. A change in this estimate would impact the Company's business. It is difficult to determine and assess the impact of a decrease in proved reserves on our impairment tests. The relationship between the reserve estimate and the estimated undiscounted cash flows is complex. As a result, the Company is unable to provide a reasonable sensitivity analysis of the impact that a reserve estimate decrease would have on its assessment of impairment. The Company does however, have confidence in its reserve estimates. In addition, the price forecasts used to determine the fair value are based on publicly posted pricing forecasts of reputable reserves evaluation firms. Had International Sovereign adopted this guideline in 2003 it would not have changed the result of the ceiling test.

Site Restoration

Site restoration on the balance sheet is accrued over the life of the asset, using the unit-of-production method of accounting. As abandonment and reclamation costs are incurred, this liability is drawn down. International Sovereign's liability at the end of 2003 was $321,993 up from $211, 991 at the end of 2002. Going forward, the CICA has issued a new handbook section called "Asset Retirement Obligations" (ARO), which changes the accounting for site restoration liabilities. This will be implemented by the Company effective January 1, 2004. The impact on the Company is currently being evaluated.

Future Income Taxes

The Company accounts for future income taxes using the liability method. Future income tax assets and liabilities are measured based upon temporary differences between the carrying values of assets and liabilities and their tax bases. Future income tax expense is computed based on the change during the year in the future tax assets and liabilities. Future income tax assets or liabilities are calculated using tax rates anticipated to apply in the periods that the temporary tax differences are expected to reverse effects of changes in tax laws, and tax rates are recognized when enacted. For the year ended 2003 this future income tax expense was calculated to be $134,502, compared to $535,474 at year end 2002.

Reserves Disclosure

Where any disclosure of reserves data is made in this MD&A that does not reflect all reserves of the Company, it should be noted that the estimates of reserves and future net revenue for individual properties or groups of properties may not reflect the same confidence level as estimates of reserves and future net revenue for all properties. Any reference to "established reserves" has the meaning of the January 1, 2003, COGE (Canadian Oil and Gas Evaluation) Handbook, proved plus 50 percent of probable reserves, which is similar but not identical to the January 1, 2004 definition of proved plus probable reserves.

Business Risks

The oil and gas industry is subject to numerous risks, including commodity prices, interest rates, exchange fluctuations, as well as environmental concerns and the success of future drilling. International Sovereign attempts to reduce and manage those risks which are controllable.

Safety and Environmental

Safety and environmental concerns are addressed through a corporate contingency plan and by continued emphasis on complying with environmental regulations.

Impact of New Accounting Pronouncements

During 2003 the following new or amended standards and guidelines were issued by the Canadian Institute of Chartered Accountants (CICA) and Canadian Securities regulatory authorities.

Hedging Relationships

Accounting Guidelines 13 (AcG 13) "Hedging Relationships", which is effective for fiscal years beginning on or after July 1, 2003, addresses identification, designation, documentation and effectiveness requirements of financial instruments to qualify for hedge accounting. It also establishes conditions for applying or discontinuing hedge accounting. Under this new guideline, hedging transactions must meet a strict set of criteria to continue to apply accrual accounting for positions hedged.

If this criteria is not met, the transaction must be accounted for using mark-to-market accounting as described in EIC 128 – Accounting for Trading, Speculative, or Non-hedging Derivative Financial Instruments, which has the same effective date as AcG 13. International Sovereign had no hedging relationships in place in 2003.

Impairment of Long-lived Assets

In December 2002, the CICA issued a new standard on the impairment of long-lived assets, which is effective for years beginning on or after April 1, 2003. The new standard requires an impairment loss for long-lived assets to be held and used to be recognized when its carrying amount exceeds the sum of the undiscounted cash flows expected from its use and eventual value, and provides guidance on how to determine fair value.

Stock Based Compensation and Other Stock Based Payments

In September 2003, the CICA issued an amendment to section 3870 "Stock based compensation and other stock based payments". The amended section is effective for fiscal years beginning on or after January 1, 2004, however, earlier adoption is recommended. The amendment requires that companies measure all stock based payments using the fair value method of accounting and recognize the compensation expense in their financial statements. International Sovereign implemented this amended standard in 2003 in accordance with the early adoption provisions. Early adoption requires that compensation expense be calculated and recorded in the income statement for options issued on or after January 1, 2003. Prior to the implementation of this standard, only pro-forma disclosure of this impact was required. See previous discussion under Stock Based Compensation in this MD&A for impact on the Company's financial statements.

Disposal of Long-lived Assets and Discontinued Operations

In December 2002, the CICA issued a new standard on the disposal of long-lived assets and discontinued operations, which is effective for disposal activities initiated by a company's commitment to a plan on or after May 1, 2003. The new standard requires an asset classified as held for sale to be measured at fair value less cost to sell, provides criteria for classifying assets as held for sale and classifying a disposal as discontinued operations, and specifies presentations and disclosures for discontinued operations and other disposals of long-lived assets.

Asset Retirement Obligations

Canadian Institute of Chartered Accountants (CICA) issued a new standard on the accounting for asset retirement obligations. This standard requires recognition of a liability for the future retirement obligations associated with property, plant and equipment. These obligations are initially measured at fair value, which is the discounted future value of the liability. The liability accretes until the date of expected settlement of the retirement obligations. The new standard is effective for all fiscal years beginning on or after January 1, 2004, however earlier adoption is encouraged.

Oil and Gas Accounting – Full Cost

In 2003, Accounting Guideline 16 "Oil and Gas Accounting – Full Cost" was issued to replace CICA Accounting Guideline 5. The new guideline amends the ceiling test calculation applied by the Company to its oil and gas assets. AcG 16 is effective for fiscal years beginning on or after January 1, 2004. Had International Sovereign adopted this guideline in 2003 it would not have changed the result of the ceiling test.

Disclosure of Guarantees

In February 2003, The CICA issued Accounting Guideline 14 "Disclosure of Guarantees" which requires that all guarantees be disclosed in the notes to the financial statements along with a description of the nature and term of the guarantee and estimate of the fair value of the guarantee. The new guideline is effective for fiscal years beginning on or after January 1, 2003. Implementation of this new guideline did not impact the Company's results for 2003.

Generally Accepted Accounting Principles and Standard of Financial Statement Presentation

In 2003, the CICA re-issued handbook section 1100 "Generally Accepted Accounting Principles" and 1400 "General Standards of Financial Statements Presentation". The amendments are effective for fiscal periods on or after October 1, 2003 on a prospective basis. The most significant amendment has been the elimination of looking to industry practice in areas where Canadian GAAP is silent. Instead, entities are encouraged to seek out other accounting bodies with specific guidance first.

Continuous Disclosure Obligations

Effective March 31, 2004 International Sovereign will be subject to new disclosure requirements as preset forth in National Instrument 51-102 "Continuous Disclosure Obligations". This new instrument is effective for fiscal years beginning on or after January 1, 2004. The instrument provides for shorter reporting periods for filing of annual and interim financial statements, MD&A and Annual Information Forms ("AIF"). The instrument also provides for enhanced disclosure in the annual and interim financial statements, MD&A and AIF. Under its new instrument, it will no longer be mandatory for the Company to mail annual and interim financial statements and MD&A to shareholders. Instead, these documents will be provided on an "as requested" basis. International Sovereign has early adopted the expanded MD&A disclosures at December 31, 2003.

Fourth Quarter 2003

In the fourth quarter of 2003 Company revenues remained fairly constant with the previous three quarters average revenues; revenue after royalties was $1,654,187 as compared to $1,772,671 in the third quarter. This decrease was primarily due to a slight decrease in heavy oil production and prices in the fourth quarter. Net income decreased from $332,966 in the third quarter to ($286,782) at the end of the fourth quarter, this being the result of a write down on the impairment of international expenditures, and also the Company had an increased current tax liability in 2003, from $23,595 in 2002 to $207,773 at year end 2003, most of which was realized and paid in the last quarter.

Outlook

International Sovereign is anticipating a very active 2004. Since January 1, the Company has participated to its 25 percent interest in the drilling of the first two wells in a three well program in the Sturgeon Lake area of Alberta. The first well has been completed as a dual zone gas discovery, with a third indicated gas zone uphole still behind pipe, and the second well has recently been cased as a potential gaswell. Completion of that well is anticipated to occur prior to breakup. Regular production from these wells could commence as early as the second quarter of this year. Gross production rates are anticipated to be approximately two mmcfd per well. The third well in the program will be drilled later this year. The Company will have earned an average working interest of 23.85 percent in 7,680 acres of land after the drilling of the third well.

In Medicine River, the drilling of a shallow Cretaceous well (50 percent working interest) and the recompletion of an existing marginal producer (45.75 percent working interest) are expected to occur after spring breakup.

The Company has generated four gas prospects in the Red Deer area of Alberta. Seismic and land acquisition is proceeding, and drilling should commence late in the second quarter on the first of these prospects.

At Maple in Northeast British Columbia, the Company will be re-entering an abandoned wellbore prior to breakup to test Triassic gas potential. Operations will be carried out at a 100 percent cost interest to the Company.

In Little Bow, Alberta, the Company was recently successful in purchasing 480 acres of Bow Island gas rights at a Crown land sale (66 2/3 percent working interest). The Company expects to pool with the other owners and twin an existing bypassed pay well after breakup. Expected production to the Company's account is 500 mcfd.

On the international front, the Company's initiatives with the Federation of Union of Communities of Ecuadorian Amazon (FCUNAE) to jointly acquire and develop hydrocarbon concessions within the Ecuadorian Oriente Basin continue to progress.

In central Asia, the Company continues its discussions with a prominent private corporation to acquire projects on a joint venture basis, for the exploration and development of hydrocarbon reserves within the region.

Annual and Quarterly Information

2003 Quarterly Information ($)	Qtr1	Qtr2	Qtr3	Qtr4	Annual
Gross Revenues after Royalties	1,882,356	1,526,246	1,772,671	1,654,187	6,835,460
Total Assets	12,438,199	12,992,665	13,877,693	14,902,911	14,902,911
Cash Flow from Operations	1,365,494	1,011,970	1,078,111	314,098	3,769,673
Basic Per Share	0.21	0.16	0.16	0.03	0.56
Diluted Per Share	0.21	0.15	0.15	0.01	0.52
Net Income	755,657	581,354	332,966	(286,782)	1,383,195
Basic Per Share	0.12	0.09	0.05	(0.05)	0.21
Diluted Per Share	0.11	0.09	0.05	(0.06)	0.19

2002 Quarterly Information ($)	Qtr1	Qtr2	Qtr3	Qtr4	Annual
Gross Revenues after Royalties	828,359	1,518,515	1,350,541	1,428,925	5,126,340
Total Assets	11,214,362	11,687,667	11,953,031	11,717,680	11,717,680
Cash Flow from Operations	449,724	1,001,167	832,030	609,098	2,892,019
Basic Per Share	0.07	0.16	0.13	0.09	0.45
Diluted Per Share	0.07	0.15	0.13	0.09	0.44
Net Income	138,971	607,045	181,033	(198,123)	728,926
Basic Per Share	0.02	0.09	0.03	(0.03)	0.11
Diluted Per Share	0.02	0.09	0.03	(0.03)	0.11

2001 Quarterly Information	Qtr1	Qtr2	Qtr3	Qtr4	Annual
Gross Revenues after Royalties	1,261,893	985,520	1,068,006	596,149	3,911,568
Total Assets	10,079,164	10,115,413	10,242,226	10,748,366	10,748,366
Cash Flow from Operations	840,142	450,617	521,776	83,586	1,896,121
Basic Per Share	0.13	0.07	0.08	0.01	0.29
Diluted Per Share	0.13	0.07	0.08	0.01	0.29
Net Income	569,261	193,218	221,593	(538,652)	445,420
Basic Per Share	0.09	0.03	0.03	(0.08)	0.07
Diluted Per Share	0.09	0.03	0.03	(0.08)	0.07

For the purpose of cash flow per share calculations, cash flow is defined as "Cash flow from operations" before the changes in non-cash working capital. This definition is not a recognized measure under Canadian generally accepted accounting principles and accordingly may not be comparable to measures used by other companies.

Based on the above, the Company has showed steady growth over the past three years in all critical areas and is poised for continued steady growth.

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MANAGEMENT'S REPORT

To the Shareholders of International Sovereign Energy Corp.

The information contained in this annual report and the accompanying financial statements and other financial information as well as the reporting process that produces such statements is the responsibility of Management.

Management maintains a system of internal controls designed to reasonably assure that transactions are appropriately authorized, that relevant and reliable financial information is produced in a timely manner and that the assets of the Corporation are adequately safeguarded.

The Management of the Company has the responsibility for the integrity and objectivity of the information contained in this annual report and to ensure that the operating information presented throughout this annual report is consistent with that shown in the financial statements, which are prepared by Management in accordance with generally accepted accounting principles.

The external auditors, appointed by the shareholders of the Company have examined the financial statements in order to provide an independent view as to the fairness of reported operating results and financial condition.

The Audit Committee of the Board of Directors which consists primarily of non-management directors have reviewed the financial statements including notes thereto, with Management and has reported to the Board of Directors.

The financial statements, upon the recommendation of the Audit Committee, have been approved by the Board of Directors.

Lutfur Rahman Khan
Chief Executive Officer

Omair Choudhry
Chief Financial Officer

Calgary, Alberta
March 5, 2004

AUDITORS' REPORT

To the Shareholders of International Sovereign Energy Corp.

We have audited the consolidated balance sheets of International Sovereign Energy Corp. (the "Company") as at December 31, 2003 and 2002 and the consolidated statements of operations and retained earnings and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants

Calgary, Alberta

March 5, 2004

CONSOLIDATED BALANCE SHEETS

December 31	2003 $	2002 $
ASSETS		
CURRENT		
Cash	409,994	13,057
Accounts receivable	1,141,990	598,693
Prepaid expenses and deposits	2,500	6,800
	1,554,484	618,550
Property and equipment (Note 3)	13,348,427	11,099,130
	14,902,911	11,717,680
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities	1,690,593	592,061
Operating loan (Note 4)	–	–
	1,690,593	592,061
Future income tax liability (Note 5)	2,941,302	2,806,800
Site restoration and abandonment provision	321,993	211,991
	4,953,888	3,610,852
SHAREHOLDERS' EQUITY		
Share capital (Note 6)	6,693,734	6,234,734
Retained earnings	3,255,289	1,872,094
	9,949,023	8,106,828
	14,902,911	11,717,680

Approved by the Board

Director

Director

CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

Years Ended December 31	2003 $	2002 $
REVENUE		
Petroleum and natural gas revenues	7,917,716	5,714,310
Royalties, net of ARTC	(1,088,134)	(592,350)
Other income	5,878	4,380
	6,835,460	5,126,340
EXPENSES		
Operating costs	1,654,568	1,193,478
General and administrative (Note 3)	1,196,771	989,681
Interest	6,675	27,567
Depletion and depreciation	2,120,198	1,548,272
Site restoration	131,778	79,347
	5,109,990	3,838,345
EARNINGS BEFORE INCOME TAXES	1,725,470	1,287,995
INCOME TAXES		
Current	207,773	23,595
Future (Note 5)	134,502	535,474
	342,275	559,069
NET EARNINGS (Note 8)	1,383,195	728,926
RETAINED EARNINGS, BEGINNING OF YEAR	1,872,094	1,143,168
RETAINED EARNINGS, END OF YEAR	3,255,289	1,872,094

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31	2003 $	2002 $
CASH FLOWS RELATED TO THE FOLLOWING ACTIVITIES:		
OPERATING		
Net earnings	1,383,195	728,926
Adjustments for:		
Depletion and depreciation	2,120,198	1,548,272
Site restoration	131,778	79,347
Future income taxes	134,502	535,474
Cash flow from operations	3,769,673	2,892,019
Site restoration costs incurred	(21,776)	(71,722)
	3,747,897	2,820,297
Changes in non-cash working capital		
Accounts receivable and prepaid expenses and deposits	(538,997)	66,504
Accounts payable and accrued liabilities	852,854	(324,310)
	4,061,754	2,562,491
FINANCING		
Issuance of common shares	459,000	–
Decrease in operating loan	–	(195,000)
	459,000	(195,000)
INVESTING		
Additions to property and equipment	(4,511,325)	(2,571,033)
Proceeds on sale of property and equipment	141,830	–
	(4,369,495)	(2,571,033)
Changes in non-cash working capital		
Accounts payable and accrued liabilities	245,678	335,422
	(4,123,817)	(2,235,611)
NET INCREASE IN CASH	396,937	131,880
CASH (BANK INDEBTEDNESS), BEGINNING OF YEAR	13,057	(118,823)
CASH, END OF YEAR	409,994	13,057
SUPPLEMENTARY INFORMATION		
Cash taxes paid	29,301	61,372
Cash interest paid	6,675	27,683

Years Ended December 31, 2003 and 2002

1. NATURE OF BUSINESS

International Sovereign Energy Corp., and its subsidiary (the "Company") are in the business of exploration for and development of petroleum and natural gas interests.

2. SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles.

Consolidation

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary incorporated in Ecuador.

Cash and cash equivalents

Cash and cash equivalents include cash and short-term investments with a maturity of 90 days or less at the time of issue.

Property and equipment

The Company follows the full cost method of accounting for oil and gas operations as prescribed by the Canadian Institute of Chartered Accountants. All costs related to exploration and development of oil and gas reserves are capitalized on a country by country basis. Such costs include lease acquisition costs, geological and geophysical expenses, carrying charges on non-producing properties, costs of drilling productive and non-productive wells and overhead charges related directly to acquisition, exploration and development activities.

Costs of acquiring and evaluating unproven properties in Canada and costs of exploration and land in international cost centers are excluded initially from costs subject to depletion, until it is determined whether or not proved reserves are attributable to the properties or, in the case of major development projects, commercial production has commenced, or impairment has occurred. Impairment occurs whenever events of changes in circumstances indicate that the carrying amount may not be recoverable. When proven reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to the costs subject to depletion for that country's cost centre. Proceeds from disposal of properties will normally be applied as a reduction of the cost of the remaining assets unless the disposal represents a significant disposition of reserves, in which case a gain or loss will be recorded.

The net carrying value of the Company's petroleum and natural gas properties for each country is limited to an ultimate recoverable amount. This is the aggregate of future net revenues from estimated proved reserves and the costs of unproved properties, net of impairment allowances, less future general and administrative costs, financing costs, site restoration and abandonment costs, and income taxes. Future net revenues are estimated using year-end prices and all costs are assumed to be constant.

For each cost center, the capitalized costs associated with proven reserves, including the costs of production equipment, are depleted and depreciated on the unit-of-production method based on the estimated proven reserves before royalties, determined by independent petroleum engineers. Oil and gas reserves and production are converted into equivalent units based upon estimated relative pricing content at a ratio of six thousand cubic feet of gas to one barrel of oil.

Site restoration and abandonment

The estimated cost for future site restoration and abandonment is provided on the unit-of-production method based on the estimated remaining proven reserves and is included in site restoration expense. Estimates are prepared by the Company's engineers based on current costs and regulations in effect at the balance sheet date. Site restoration and abandonment expenditures are charged to the accumulated provision account as incurred.

Revenue recognition

Petroleum and natural gas revenues are recognized when the commodities are sold and title passes to the customer.

Joint venture accounting

A portion of the Company's exploration and production activities is conducted jointly with others and, accordingly, these consolidated financial statements reflect only the Company's proportionate interest in such activities.

Financial instruments
The carrying values of cash, accounts receivable and accounts payable and accrued liabilities approximate the fair value of these financial instruments due to the short-term nature of these instruments.

Foreign currency translation
Transactions of the Company and its subsidiary that are denominated in foreign currencies are recorded in Canadian dollars at exchange rates in effect at the related transaction dates. Assets and liabilities denominated in foreign currencies are adjusted to reflect exchange rates

at the balance sheet date. Exchange gains and losses arising on the translation of monetary assets and liabilities are included in the determination of income for the year.

Stock-based compensation plan
Effective January 1, 2003, the Company elected to prospectively adopt the fair value method of accounting for options granted subsequent to January 1, 2003 under its stock-based compensation plan as recommended by the CICA. Compensation expense has been recognized in the consolidated statement of operations with a corresponding increase recorded to contributed surplus in the consolidated balance sheet as at and for the year ended December 31, 2003 using the fair value method as described in Note 6. Previously, the Company accounted for this stock-based compensation using intrinsic values as defined by the CICA and accordingly, did not recognize compensation expense in the consolidated financial statements for share option granted to employees and directors when issued at market value.

The Company's stock-based compensation plan and the impact on net earnings and net earnings per share had compensation expense been recognized for options granted prior to 2003, using the fair value method of accounting for stock options issued to employees and directors on or after January 1, 2002, is described in Note 6.

Future income taxes
The Company accounts for future income taxes using the liability method. Future income tax assets and liabilities are measured based upon temporary differences between the carrying values of assets and liabilities and their tax bases. Income tax expense (recovery) is computed based on the change during the year in the future tax assets and liabilities. Future income tax liabilities or assets are calculated using tax rates anticipated to apply in the periods that the temporary differences are expected to reverse. Effects of changes in tax laws and tax rates are recognized when enacted.

Earnings per share
Basic earnings per common share is calculated using the weighted average number of common shares outstanding during the year. Diluted earnings per share is calculated on the basis of the weighted average number of shares outstanding during the year plus the additional common shares that would have been outstanding if potentially dilutive common shares had been issued using the "treasury stock" method.

3. PROPERTY AND EQUIPMENT

	2003 $	2002 $
Petroleum and natural gas properties	**20,627,552**	16,279,212
Furniture and equipment	**261,806**	240,651
	20,889,358	16,519,863
Less accumulated depletion and depreciation	**7,540,931**	5,420,733
	13,348,427	11,099,130

During the year, the Company capitalized general and administrative expenditures of $770,778 (2002 – $939,982) directly related to both Canadian and international exploration and development activities.

Costs of $2,740,197 related to undeveloped properties were not subject to depletion during year ended December 31, 2003 (2002 – $2,046,776). At year end December 31, 2003 capitalized costs of $461,563 in Pakistan, Morocco, Angola and Russia (2002 – $671,422) related to the impairment of certain international cost centers have been charged to depletion.

Site restoration amortization expense of $131,778 for the year ended December 31, 2003 is based on a total future estimated liability of $1,311,300 (2002 – $1,034,700).

4. OPERATING LOAN

During the year, the Company secured a revolving line of credit to a maximum of $4,400,000. The operating loan bears interest at prime plus 0.75% and is secured by a demand debenture for a minimum of $5,000,000, providing a floating charge over all assets of the Company, and a letter of undertaking not to encumber or dispose of assets, other than in the normal course of business, without consent of the Bank, and to provide security under section 426 of the Bank Act and/or assign natural gas contracts. At December 31, 2003, there was no balance outstanding with respect to this facility (2002 – Nil). In addition, the lender has issued on behalf of the Company letters of credit totaling $7,500 (2002 – $7,500) to maintain its status as a licensed well operator in the province of British Columbia.

5. FUTURE INCOME TAXES

The provision for taxes varies from the amounts that would be computed by applying the effective Canadian federal and provincial income tax rates to earnings before income taxes as shown below:

	2003 $	2002 $
Earnings before income taxes	**1,725,470**	1,287,995
Corporate income tax rate	**40.74%**	42.12%
Computed income tax provision	**702,956**	542,503
Increase (decrease) resulting from:		
Non-deductible crown charges, net of ARTC	**326,946**	239,818
Taxable resource allowance	**5,051**	(43,656)
Resource allowance	**(212,420)**	(154,974)
Attributed Canadian royalty income	**(56,502)**	(36,312)
Non-deductible expenses	**3,341**	3,307
Capital tax	**–**	2,268
Impact of changes in effective tax rate	**(432,359)**	(26,646)
Other	**5,262**	32,761
	342,275	559,069

The major components of the future income tax liability at December 31 using a combined federal and provincial rate of 36.20% (2002 – 42.12%) are as follows:

	Future Tax Liability	
	2003 $	2002 $
Taxable temporary differences:		
Carrying value in excess of tax basis	**3,063,313**	3,014,249
Attributed Canadian royalty income carryforward	**(122,011)**	(163,793)
Differences in capital cost allowance claim for resource allowance	**–**	(43,656)
Balance, December 31	**2,941,302**	2,806,800

6. SHARE CAPITAL

	Number of Shares	**Amount $**
Authorized		
Unlimited number of Class A common voting shares		
Unlimited number of Class B common non-voting shares		
Unlimited number of Class A preferred voting, 7%, non-cumulative, redeemable shares		
Issued		
Class A common shares	6,445,323	**6,234,734**
Balance, December 31, 2002 and 2001	6,445,323	**6,234,734**
Issued, August 7, 2003	655,713	**459,000**
Balance, December 31, 2003	7,101,036	**6,693,734**

On August 7, 2003 the Company closed a private placement with both arm's length third parties and non-arm's length parties. The Company issued 655,713 units at a price of $0.70 per unit. Each unit is comprised of one (1) common share and one (1) warrant in the capital of the Company. Upon exercise, each warrant entitles the holder thereof to acquire one (1) common share at a price of $0.90 until 5:00pm June 30, 2005. Shares issued under the transaction are subject to applicable hold periods. No value has been attributed to the warrants.

Stock option plan

Under the Company's stock option plan, the Company may grant options to its directors, officers and key employees to purchase Class A common shares ("Common Shares") from the Company at a fixed price not less than the fair market value of the stock on the day preceding the grant date. The Company has reserved 710,103 common shares for the grant of options. The options would vest equally over three years. The option's maximum term is five years.

	Options	Weighted Average Exercise Price ($)
As at December 31, 2001	467,667	0.50
Granted	175,000	0.65
Cancelled	(58,000)	0.50
As at December 31, 2002	584,667	0.55
Granted	–	–
Cancelled	–	–
As at December 31, 2003	584,667	0.55
Exercisable at December 31, 2003	422,133	0.51

The following table summarizes information about stock options outstanding at December 31, 2003:

Range of Exercise Price(s) $	Options Outstanding at December 31, 2003	Remaining Contractual Life (Years)	Weighted Average Exercise Price $	Weighted at December 31, 2003	Weighted Average Exercise Price $
0.50	404,667	1.1	0.50	404,667	0.50
0.60	5,000	1.6	0.60	5,000	0.60
0.65	175,000	3.9	0.65	12,466	0.65
0.50 – 0.65	584,667			422,133	0.51

Pro Forma Accounting For Stock-Based Compensation

Using the fair value method of accounting for stock options issued to employees on or after January 1, 2003, the Company recognized compensation expense in the consolidated statement of earnings, with a corresponding increase recorded to contributed surplus in the consolidated balance sheet as at and for the year ended December 31, 2003. The weighted average fair value of options granted during the year ended December 31, 2003 was nil.

If compensation costs for stock options of the Company issued on or after January 1, 2002 has been determined based on the fair value methodology, using the Black-Scholes option pricing model, the Company's net earnings and earnings per share would have been decreased to the pro forma amounts indicated below:

Year Ended December 31,	2003 $	2002 $
Net earnings applicable to common shareholders as reported	**1,383,195**	728,926
Pro forma net income applicable to common shareholders	**1,368,507**	727,939
Earnings per common share as reported		
Basic	**0.21**	0.11
Diluted	**0.19**	0.11
Pro forma earnings per common share		
Basic	**0.20**	0.11
Diluted	**0.19**	0.11

The fair value of each option grant by the Company was estimated using the Black-Scholes option pricing model assuming no dividends are paid on common shares, a risk-free interest rate of 4.06%, an average life of 5 years and a volatility of 89%. The amounts computed according to the Black-Scholes option pricing model may not be indicative of the actual values realized upon the exercise of these options by the holders.

7. RELATED PARTY TRANSACTIONS

During the year, the Company recovered Nil in general and administrative expenses (2002 – $33,357) from a corporation which has a director in common with the Company. At December 31, 2003, accounts payable of $20,852 (2002 – $22,683) include balances owing to a company which have a director in common with the Company. During the year, the Company paid $85,525 (2002 – $43,833) for legal services in the normal course of business to a law firm of which the partner is an officer of the Company. Also, effective March 1, 2003, the Company sold a minor interest property to a Corporation which has an officer in common with the Company, for a consideration of $46,000. Transactions are determined at their fair value.

8. EARNINGS PER COMMON SHARE

	2003	2002
Earnings per common share		
Basic	**$ 0.21**	$ 0.11
Diluted	**$ 0.19**	$ 0.11
Weighted average number of common shares		
Basic	**6,709,405**	6,445,323
Diluted	**7,223,279**	6,551,018

No options were excluded from diluted earnings per share as all the options were in the money in both 2003 and 2002.

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company is subject to normal industry credit risk on its accounts receivable with customers and joint venture partners. The Company mitigates these risks by only entering into agreements with credit worthy parties.

The Company is exposed to fluctuations in commodity prices for natural gas, crude oil and natural gas liquids. Commodity prices are affected by many factors including supply, demand and the Canadian to US dollar exchange rate. The Company's operating loan is also exposed to fluctuations in short-term Canadian interest rates. The Company has no financial hedges or fixed price commodity contracts in place at December 31, 2003.

The fair market value of financial instruments consisting of cash, accounts receivable, accounts payable and accrued liabilities approximate their carrying value due to their short-term nature. The operating loan bears interest at a floating market rate, accordingly, its carrying value approximates fair value.

10. **COMMITMENT**
The Company has committed to a lease for office premises expiring in August of 2006. The minimum annual payment required on the lease is $84,925.

11. **SEGMENTED INFORMATION**
The Company sells its petroleum and natural gas products to various purchasers. For 2003, three large integrated purchasers accounted for 57%, 9% and 11% (2002 – 72%, 10% and 6%) of the Company's gross revenues.

The Company's core area of operation is in Canada. The Company is currently investigating opportunities in other countries. Total amounts spent in 2003 on international investigations were $694,528 (2002 – $820,268).

12. **SUBSEQUENT EVENT**
On February 12, 2004 the Company sold a non-core, non-producing asset at Buckinghorse in northeastern British Columbia for proceeds of $877,500.

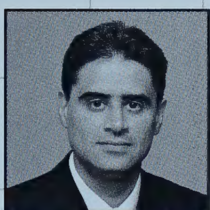
March 01, 2004
A Historic day for *International Sovereign Energy Corp.*

CORPORATE INFORMATION

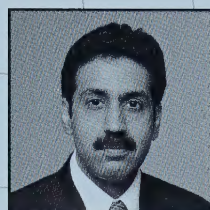
Lutfur Rahman Khan
President and C.E.O.

Donald G. Campbell
Sr. Vice President Engineering & Production and C.O.O.

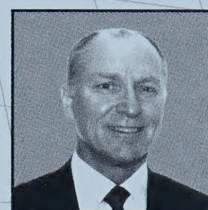
George P. Bowley
Sr. Vice President Exploration & Development



Omair Choudhry
Sr. Vice President Finance and C.F.O.



Dr. Waseem Rahman
Sr. Vice President Administration



Timothy S. Hoar
Corporate Secretary & General Counsel

Directors

Lutfur Rahman Khan (2)(3)

Mahmood Arshad (1)(2)(3)

Afzal Mahmood (1)(2)(3)

Qamar Malik, PhD. (1)

Desmond Smith

(1) Member of the Audit Committee

(2) Member of the Compensation Committee

(3) Member of the Executive Committee

Officers

Lutfur Rahman Khan

President and Chief Executive Officer

Donald G. Campbell

Sr. Vice President Engineering & Production and Chief Operating Officer

George P. Bowley

Sr. Vice President Exploration & Development

Dr. Waseem Rahman

Sr. Vice President Administration

Omair Choudhry

Sr. Vice President Finance & Chief Financial Officer

Timothy S. Hoar

Corporate Secretary & General Counsel

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Deloitte & Touche LLP
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Chapman Petroleum Engineering Ltd.
Calgary, AB

Legal Counsel
ProVenture Law
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Stock Exchange Listing
TSX Exchange
Symbol "ISR"

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www.isove.com